

# Quarterly Insight

Johnson Private Client Group | Johnson Trust Company | Johnson Institutional Management

First Quarter 2018

## Market Update

### Volatility Returns; Stocks Post Quarterly Loss

After nothing but smooth sailing in 2017, volatility returned with a vengeance in the first quarter of 2018. A very strong January rally was followed by two consecutive months of losses for the broader market. For the Dow Jones Industrial Average and the S&P 500 Index the quarterly loss was the first since the third quarter of 2015. It's been two years since the S&P 500 had two consecutive months of losses. Overseas, stock markets also experienced renewed volatility and most indices ended the quarter with losses. Stocks were up and down a lot in February and March with several large one-day moves of more than 2%. Some of these moves occurred in a matter of hours. After a long stretch with hardly any such days, investors were set on edge.

The volatility also brought a fair amount of dispersion of performance between different areas of the market. Growth stocks outperformed value stocks by a wide margin, continuing a trend that has been in place for several quarters. Large cap stocks were outdone by mid and small cap stocks, which fared much better after underperforming most of the past several years. Interestingly, the usually-defensive consumer staples and telecom sectors were the worst performers, while technology and consumer discretionary stocks finished at the top.

### Tech Sector Under Pressure

The tech-heavy NASDAQ managed to finish with gains despite steep selloffs in March. Several of the largest companies like Amazon, Facebook, and Google were hit hard. Tech stocks have been the darling of the market in the past year, far outpacing the other sectors and the overall index, which left them vulnerable to such a shift. The tech losses spilled over to the rest of the market, in part because of their large weighting in the S&P 500 (almost 25%), but also because of the negative effect on overall investor sentiment. The tech weakness was sparked by some company-specific issues for the likes of Facebook and Amazon.

The negative headlines for those companies damaged investors' convictions about the prospects for the tech sector in general. However, overall fundamentals for the sector are healthy, as many companies have large cash balances and better growth prospects than the rest of the market.

### Trade War Talk Hits Stocks; but Actual Impact May Be Overstated

In addition to the tech sector issues, fears of a global trade war put pressure on the market. President Trump made much of his trade agenda throughout the campaign and first year in office, and with the passage of tax reform his focus shifted to this issue. In early March the White House announced its intentions to impose tariffs on steel and aluminum imports.

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## TOTAL RETURNS

	2018
S&P 500	-0.8%
Dow Jones Industrial Average	-2.0%
NASDAQ	2.6%
Russell 2000	-0.1%
MSCI EAFE (International)	-1.7%
Barclays Aggregate Bond Index	-1.5%

## ► Market Update (continued from page 1)

Trump has directed most of his criticism toward China, particularly regarding unfair practices related to pricing and market access, as well as intellectual property abuses. While China has received the lion's share of the heat, these tariffs would also affect a wide swath of trading partners, including some of America's closest allies. After the initial announcement the White House indicated that exceptions to these tariffs would be granted to certain nations, and in a short time many of the countries initially affected had been granted one.

China was quick to express its intentions to retaliate with tariffs of its own, and announced those plans in late March. Both governments made additional announcements of more tariffs in the ensuing days. The latest U.S. announcement calls for additional tariffs on \$100 billion of Chinese products. The statement accuses China of choosing to "harm our farmers and manufacturers." President Trump has called upon U.S. officials to use their authority to protect U.S. business interests. Still, the statement makes clear the U.S. is willing to negotiate with China.

These back-and-forth announcements are being viewed as the opening proposals in what promises to be a longer negotiation process. There will likely be plenty of headlines and heated rhetoric, but expectations of a broad trade war that damages the global economy are low. All parties understand the need for economic cooperation in order to keep the economy growing. China and the U.S. in particular are heavily dependent on one another, so all sides have significant incentive to come to reasonable terms. It's too early to predict what the effect will be on the U.S. or global economy, but for now trade talk seems like more of a hit to market sentiment than anything else.

### **Economic and Business Fundamentals Continue to Flourish**

Meanwhile, the U.S. economy remains on solid footing, and growth is expected to continue. The healthy economy along with solid corporate earnings growth are acting as supports for the market amid the trade turmoil. This positive backdrop has also helped reduce anxiety about rising inflation, rising government deficits, and a hawkish Fed, which plans to continue increasing interest rates in the coming months. Most economic data points are not indicating recession is in the cards in the near future, but it's

also true that the current economic expansion is one of the longest in history.



Interest rates increased again in the first quarter, leading to declines for bond prices. Short-term rates continued to increase at a faster pace than longer-term rates, leading to further flattening in the yield curve. Rising rates have come as a result of Fed tightening, continued economic growth, and increasing inflation expectations. Interest rates draw a lot of attention, as the rate of change is seen as a key factor in whether the economic expansion will continue. The Fed is trying to strike a balance between going fast enough to prevent economic overheating without going so fast as to choke off growth.

The first-quarter selloff was not accompanied by a drop in corporate earnings, bringing stock-market valuations down. In general, valuations remain elevated relative to long-term averages, but the recent drop creates potential room for further upside. Corporations are faring well, supported by economic growth, reduced tax rates, still-low interest rates, and higher organic growth. Corporate earnings are crucial to stock market returns, so the general strength in earnings is a solid support for the market as the year progresses.

## ► Bond Investing and Rising Interest Rates

Interest rates have been rising from the historically-low levels reached in the wake of the financial crisis. In December 2015 the Fed announced its first rate hike, and since then it has done so five more times. Meanwhile, inflation data and economic growth have also picked up, and all these factors have led to increasing rates for all types of bonds.

As interest rates rise, bond prices fall. So why would anyone invest in bonds when interest rates are expected to rise?

For one thing, it's important to know that bonds can deliver positive total returns even if bond prices fall. This is because the interest income, also known as yield, is sometimes more than enough to offset bond price decreases.

## CONTINUED...Bond Investing and Rising Interest Rates

With that said, the most important reason to include investment-grade bonds in portfolios is to protect against stock market downturns. A diversified mix of high-quality, investment-grade bonds provides much-needed stability when stocks are falling. In such an environment bonds provide the necessary liquidity to meet client cash flow needs, allowing investors to avoid selling stocks at steep discounts. This allows clients to hold onto those stocks until the storm has passed and stock prices recover.

In addition, there is no guarantee that interest rates will continue to go up. While the Fed has indicated its plan to hike interest rates further in the coming quarters, it's also willing to change course if the economic situation deteriorates. And when interest rates fall, bond prices rise. Such a scenario would likely lead to positive bond returns.

Today, bond index yields stand at six-year highs. This means that bond prices are more attractive than they have been in years. It also means the total return outlook for bonds is better than it has been in years. This is because the current yield of a bond portfolio is the most reliable predictor of its return potential.

While rates are expected to rise, the market may be approaching a point where rates begin to plateau. The Fed has indicated that its terminal Fed Funds rate target is 3%

(the Fed Funds rate is currently 1.75%). This should prevent market rates from rising beyond much beyond that, and rates on Treasury bonds are already near those levels. As of this writing, the 30-year U.S. Treasury bond yield is north of 3%, and the ten-year Treasury note yield is around 2.8%. As a result, even aggressive assumptions regarding rate hikes allow for modestly-positive returns for investment-grade bonds in 2018.



## ► JIC News

### JIC Sponsors University of Cincinnati LWiB Empowerment Day

Johnson Investment Counsel was a sponsor at the 2nd Annual University of Cincinnati Lindner Women in Business (LWiB) Empowerment Day on Saturday, March 3rd. This is a new sponsorship in 2018 as we continue to focus on women's initiatives in the community and at JIC. The conference aims to surround young women with successful business leaders and help them achieve their fullest potential. The LWiB program has a clear vision to prepare each woman for the workforce by instilling the passion and skills to achieve their goals and foster a network for success.

There were over 250 attendees including students and faculty. JIC's Chief Operating Officer, Holli Alexander, introduced the Dean of UC's College of Business. Associate Portfolio Managers Aliya Riddle and Max Monk hosted a breakout session titled "Funding Your Future." Their interactive session covered the basics of investing and gave attendees of the session the tools needed to feel more confident when making investment decisions after graduation.

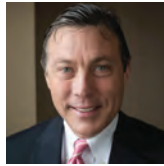




## Expanding Our Presence in Dayton

We are pleased to announce the acquisition of Riazzi Asset Management (RAM), a Dayton, Ohio-based investment firm with \$143 million in assets under management. This move demonstrates a continued focus on the Dayton market and our overall desire to serve more people. As a result of the acquisition, we are excited to welcome two new employees to the existing JIC team in Dayton - RAM Principal John Riazzi and Client Service Director Elizabeth Schaefer.

- > John Riazzi, CFA  
Portfolio Manager
- > Elizabeth Schaefer, CIMA®  
Portfolio Manager



Riazzi

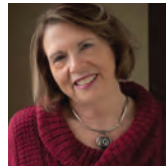


Schaefer

## New Additions to the Team

We are pleased to announce that the following individuals have joined Johnson Investment Counsel over the last several months:

- > Diane Buchanan  
Risk Associate
- > Amy Cumbow  
Client Support Assistant
- > Carrie Dunfee  
Senior Operations Associate
- > Morgan Miller  
Trust Operations Associate
- > Diane Spitznagel, Esq.  
Trust Officer



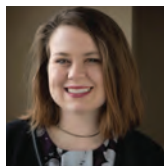
Buchanan



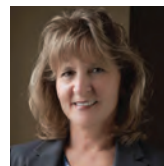
Cumbow



Dunfee



Miller



Spitznagel

## New Designations

Johnson Investment Counsel is committed to continuing education to provide personal development for our employees and better service to our clients.

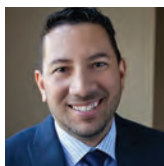
Jim Hunter, Portfolio Manager, recently earned his Accredited Investment Fiduciary (AIF®) designation. The AIF® designation relates to company retirement plans and helps us better serve plan trustees from a compliance perspective. Jim also holds the CFP® designation and is a CFA charterholder.

Dom Robles, Trust Officer, has recently earned the Certified Trust and Financial Advisor (CTFA) designation. The CTFA is widely recognized in the trust industry for advanced competence in fiduciary and trust activities, financial planning and tax law.

Scott Wyckoff, Portfolio Manager, has earned the Certified Financial Planner (CFP®) designation. He is also a CFA charterholder. JIC currently has 18 Certified Financial Planners on staff.



Hunter



Robles



Wyckoff

## Locations

Cincinnati | Cincinnati-Kenwood | Cleveland-Akron | Columbus | Dayton

## About Us

Johnson Investment Counsel, Inc. is Ohio's largest independent wealth management firm, managing over \$10 billion in assets. Johnson Investment Counsel is an employee-owned firm, offering a full range of fee-only, integrated wealth management services, including: investment portfolios, education and retirement planning, cash management, estate planning, trust services, charitable giving, mutual funds, 401(k) plans, IRAs and more. Johnson Investment Counsel has built strong, long-term relationships with individuals and families, charitable organizations, foundations and corporations through three divisions: Johnson Private Client Group, Johnson Trust Company, and Johnson Institutional Management.

### Divisions

- Johnson Private Client Group
- Johnson Trust Company
- Johnson Institutional Management

### Services

- Stock Portfolios
- Bond Portfolios
- Balanced Portfolios
- Integrated Wealth Management
- Trust Accounts
- Pension & Profit Sharing Plans
- Individual Retirement Accounts
- 401(k) Plans
- Foundations
- Endowments
- Johnson Mutual Funds
- Johnson Charitable Gift Fund



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